



COUNCIL AGENDA: 08-26-03
ITEM:

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Del D. Borgsdorf

**SUBJECT: APPROVAL OF 2003-2004
GENERAL FUND
REBALANCING PLAN**

DATE: August 13, 2003

Council District: City-wide

RECOMMENDATION

It is recommended that the City Council:

1. Approve the 2003-2004 General Fund Rebalancing Plan recommended in this memorandum and detailed in Attachments A and B.
2. Consistent with prior direction, unfreeze 26 of the 28 General Fund capital projects previously placed on hold pending resolution of the State budget as detailed in Attachment C. Approve the elimination of two of the frozen General Fund capital projects as part of the above-described rebalancing strategy.
3. Direct staff to return with Appropriation Ordinance and Funding Sources Resolution amendments and amendments to applicable fee resolutions necessary to implement the above actions.

BACKGROUND

As the City Council is aware, the State of California faced an unprecedented budget challenge this year with a 2003-2004 fiscal year shortfall estimated at \$38 billion. The State Senate and Assembly have now approved budget bills that the Governor has signed into law. As expected, the State budget includes a number of provisions that negatively impact the City's current General Fund Adopted Budget. This impact is estimated to be approximately \$10.8 million in 2003-2004, with \$400,000 of that amount being an ongoing loss.

In addition, budget actions are necessary to reflect the absence of a five-day mandatory unpaid furlough program for employees that was included as an ongoing \$3.5 million reduction in the budget adopted by the City Council in June. This memorandum is written to provide recommendations to close the \$14.3 million gap in the General Fund budget resulting from these two actions.

ANALYSIS

2003-2004 General Fund Budget Shortfall

A shortfall in the 2003-2004 General Fund Adopted Budget has been created as a result of two factors. The first is the impact of recently approved State budget-balancing provisions. Although there are a number of elements of the State budget balancing plan which result in revenue losses to the City, all but two of those impacts were presumed and accommodated in the 2003-2004 Adopted Budget. The two impacts not resolved in the Adopted Budget occur in the Vehicle License Fee (VLF) and Interest Earnings categories as described below.

The second budget problem category results from the failure to achieve agreement with City bargaining units on the savings which would have accrued from a five-day mandatory unpaid furlough for employees and that had been part of the balancing strategy assumed in the Adopted Budget.

Vehicle License Fees - By far the largest incremental loss to the budget results from the decision by the State to eliminate VLF backfill funding from the time when higher VLF fees were authorized in late June until revenue from the increase actually will begin to flow to local governments. This “gap” is approximately three months, and the loss to the City of San José is estimated to be approximately \$10.5 million for 2003-2004.¹

Interest Earnings - A portion of the State budget plan is commonly known as the “Triple Flip”. In this strategy, the State “swaps” ½ cent of the Bradley-Burns sales tax for an equal amount of property tax beginning in 2004-2005. The ½ cent sales tax lost at the local level is then reenacted at the State level and is used as a dedicated stream of revenue to pay the debt service costs for borrowing a portion of its budget. On an ongoing basis, however, the “swap” will result in a loss of interest earnings to the City, since property tax reimbursement payments for the sales tax lost would only be paid twice a year (in January and May) compared to sales tax advances and payments currently received on a monthly basis. This loss is estimated at approximately \$400,000 and will be incurred for three years beginning in fiscal year 2004-2005. In addition, the loss of VLF revenue described above will result in a one-time loss of approximately \$300,000 in interest earnings in 2003-2004.

Five-Day Unpaid Furlough - Finally, the City Council-approved budget presumed savings from a mandatory five-day furlough for all employees as a balancing measure valued at \$3.5 million on an ongoing basis. Unfortunately, the City was unable to reach agreement on this proposal with any of its bargaining units and now must formulate alternative budget balancing strategies to fill the gap.

The combined effect of the State budget impacts and the loss of savings from the furlough is a 2003-2004 General Fund budget shortfall totaling \$14.3 million with an ongoing negative impact of \$3.9 million as detailed in Table I.

¹ VLF revenues from the increased VLF tax will continue to ramp up between the June “trigger” date and October 1 when the VLF will be at full implementation.

TABLE I
General Fund Budget Shortfall

	2003-2004	Ongoing
State Budget Impact		
Vehicle License Fee (VLF)	\$ (10,526,000)	\$ 0
Lost Interest Earnings on VLF/Triple Flip	<u>(300,000)</u>	<u>(400,000)</u>
State Budget Impact Subtotal	\$ (10,826,000)	\$ (400,000)
Absence of Five-Day Unpaid Employee Furlough	<u>(3,500,000)</u>	<u>(3,500,000)</u>
Total General Fund Budget Shortfall	<u>\$ (14,326,000)</u>	<u>\$ (3,900,000)</u>

Recommended 2003-2004 General Fund Rebalancing Plan

The General Fund Rebalancing Plan includes our recommended series of actions to close the total gap in the General Fund budget (\$14.3 million) described above. As displayed in Table II, the rebalancing plan is a combination of actions previously included in the State Budget Impact Contingency Plan (Tier II) reviewed by the City Council as part of the 2003-2004 Proposed Budget, and new proposals considered to have less impact on the City's ability to deliver services to the public. These budget balancing recommendations involve a combination of strategies including the use of reserves, utilization of additional one-time revenues, and additional ongoing reductions in City Service Area/departmental budgets.

TABLE II
General Fund Rebalancing Plan

	2003-2004	Ongoing
Additional Resources		
2003-2004 Future Deficit Reserve Elimination	\$ (5,548,231)	\$ 0
Sale of Surplus Property/Liquidation of Encumbrs.	(3,600,087)	0
Service Yards Debt Service Funding Shift	(608,272)	0
New Parks & Recr. Facilities Maint. Reserve Elim.	(224,000)	(224,000)
Other Revenue Changes	<u>(161,060)</u>	<u>(252,121)</u>
Additional Resources Subtotal	\$ (10,141,650)	\$ (476,121)
Expenditure Solutions		
Personal & Non-Personal/Equipment Eliminations/ Efficiencies	(3,506,013)	(3,210,311)
Other Funding Changes	<u>(678,337)</u>	<u>(240,837)</u>
Expenditure Solutions Subtotal	\$ (4,184,350)	\$ (3,451,148)
Total General Fund Rebalancing Plan	<u>\$ (14,326,000)</u>	<u>\$ (3,927,269)</u>
Remaining Balance	<u>\$ 0</u>	<u>\$ 27,269</u>

Attachments A and B contain the summary and detail of the 2003-2004 General Fund Rebalancing Plan. Actions that were not included in the Tier II plan are designated with an asterisk in these attachments to indicate that they are new proposals. As recommended as part of our strategy, over half of the shortfall would be closed by using the remainder of the reserve set aside specifically for balancing the 2003-2004 budget (\$5.5 million), along with the use of proceeds from the sale of surplus City properties and liquidation of encumbrances (\$3.6 million). We have also included the transfer of uncommitted Service Yards Construction and Conveyance Tax proceeds to reimburse the General Fund for Phase I Service Yard debt service costs incurred in 2002-2003 (\$0.6 million). These actions were included in the Tier II plan, and approved as part of the Mayor's June Budget Message and the Adopted Budget. Given the current continuing economic conditions and the certainty that the City faces a significant General Fund shortfall again in 2004-2005, we have not included or recommended the use of a portion of the Economic Uncertainty Reserve that was included in the Tier II plan, as we believe it to be imperative that this reserve remain intact.

The majority of the remaining recommended rebalancing actions have been formulated to include ongoing measures adequate to offset the estimated ongoing loss of revenue from State budget balancing actions and the value necessary to replace the unpaid furlough gap. This plan, again, is intended to keep us from worsening the fiscal problem that we already know faces us in the coming fiscal year.²

If approved by City Council, this recommended strategy will require the net elimination of 39.88 positions (8.0 vacant) and will have additional negative impacts on City services. These cutbacks are necessary and appropriate responses to a reduction in resources available to the City and are in keeping with our historically prudent fiscal management practices.

We also believe it is critical in formulating the current year budget rebalancing strategy to keep the additional fiscal problems that we know lie just over the horizon firmly in mind. Just as the City's current economic situation hit much later than the downturn felt in the private sector, our recovery will lag behind any recovery in the local economy -- and there are still no signs of improvement. It is clear, therefore, that the budget challenges will continue for some time. The 2003-2004 year's budget was balanced by using a deliberate multi-year strategy that relied, in part, on the use of one-time funding. With that strategy, however, came certain knowledge that more difficulties lay ahead. Our early projections indicate we face a likely General Fund shortfall approaching \$55 million in 2004-2005. Additional service reductions next year will be unavoidable. We certainly have learned from the example of the State, that postponing tough decisions now will only result in having to face worse options down the road.

² Further reductions in 2003-2004 City programs funded from the Redevelopment Agency may also be necessary once the Agency formulates its plans for balancing a fiscal problem that results from both the State budget impacts and from a more severe than anticipated drop-off in local Property Tax receipts. At this time, the nature of the Agency cutbacks is not yet known.

HONORABLE MAYOR AND CITY COUNCIL

08-13-03

Subject: Approval of 2003-2004 General Fund Rebalancing Plan

Page 5

General Fund Capital Projects on Hold

As approved by the City Council, the Mayor's June Budget Message directed the Administration to unfreeze the General Fund capital projects that were placed on hold early in the calendar year pending resolution of the State Budget. Attachment C details the General Fund capital projects that are now recommended to proceed based on that direction. A total of 26 of the 28 General Fund capital projects previously placed on hold are included in that list. The Administration recommends that the City Council approve the elimination of two of the frozen General Fund capital projects (Neighborhood Park Signage Improvements and Miscellaneous Building Repairs) as part of the above-described rebalancing plan included in Attachments A and B.

DEL D. BORGS DORF
City Manager

Attachments:

Attachment A - 2003-2004 General Fund Rebalancing Plan Summary

Attachment B - 2003-2004 General Fund Rebalancing Plan Detail

Attachment C - General Fund Capital Projects Recommended to Proceed